DIRECT TESTIMONY OF

KEVIN MARSH

ON BEHALF OF

SOUTH CAROLINA ELECTRIC AND GAS COMPANY

DOCKET NO. 2002-223-E

Q. PLEASE STATE YOUR NAME, BUSINESS ADDRESS, AND POSITION.

A. My name is Kevin Marsh and my office is located at 1426 Main Street, Columbia, South Carolina. I am Senior Vice President and Chief Financial Officer of South Carolina Electric and Gas Company ("SCE&G") and hold a similar position at SCANA Corporation, which is the parent company of SCE&G.

Q. PLEASE DESCRIBE YOUR EDUCATION AND BUSINESS BACKGROUND.

A. I am a graduate, magna cum laude, of the University of Georgia, with a Bachelor of Business Administration Degree majoring in Accounting. I am also licensed as a Certified Public Accountant in the State of South Carolina and a member of the American Institute of Certified Public Accountants and the South Carolina Association of Certified Public Accountants. Prior to joining SCE&G in 1984, I was employed for seven years by the certified public accounting firm of Delliotte & Touche where I was designated an Audit

Manager as a public utility accounting and auditing specialist. I joined SCE&G in 1984 as the Group manager of Technical Accounting. In 1988, I was promoted to Controller in 1989 was elected Vice President and Controller. In 1991, I became the Vice President of Corporate Planning. I later became Vice President and Chief Financial Officer of SCE&G and was promoted to my present position as Senior Vice President and Chief Financial Officer in 1998.

Q. WHAT ARE YOUR DUTIES WITH SCE&G?

A. As Senior Vice President and CFO of SCE&G, I have responsibility for monitoring the Company's present and prospective financial condition; for formulating strategies to ensure that the Company can meet its capital requirements at the lowest reasonable cost; and for managing all accounting and financial matters related to the Company.

Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY?

A. The purpose of my testimony is to provide an overview of SCE&G's financial situation as it relates to SCE&G's decision to seek rate relief at this time. I will review SCE&G's financial and regulatory history particularly as it relates to the balanced treatment that the Company has historically received from this Commission, and the importance of that treatment to the Company's ability to operate as an efficient and reliable electric utility.

My testimony will also discuss the capital needs that the Company faces in the coming years as it seeks to meet the electric reliability requirements of its customers, the air quality requirements placed on it by environmental regulators, and the dam safety requirements placed on it by the Federal Energy Regulatory Commission. These needs must be met in a time of significant turmoil in national financial markets and in the face of increasingly stringent expectations from Wall Street and the investment community for companies that seek to access capital on favorable terms.

Q. PLEASE EXPLAIN THE ROLE THAT THE COMMISSION HAS PLAYED IN THE FINANCIAL AND REGULATORY HISTORY OF SCE&G AND SCANA.

A. The regulatory support that SCE&G has received from this Commission over the years has played a key role in the success of SCE&G as an independent, South Carolina based utility.

That support has been balanced. The Commission has consistently held SCE&G accountable for prudent, cost-effective and efficient utility operations. Nonetheless, at critical points in SCE&G's history, clear statements of regulatory support from the Commission were needed to assure the financial markets that the Company would be allowed rates sufficient to fund its continued investment in facilities needed to satisfy South Carolina's growing electric demand. At those times, the markets required assurances of sufficient and reasonable revenue levels, along with an adequate return on equity, for the Company to maintain its financial health and to preserve its access to capital markets on reasonable terms. In each such case, the Commission signaled its commitment to balanced regulation for SCE&G in tangible ways that the markets clearly understood.

Q: COULD YOU GIVE US A SPECIFIC EXAMPLE OF THIS TYPE OF SUPPORT.

A. The single best example was the support the Commission gave SCE&G during the energy crisis of the mid –1970s. In the 1960s and early 1970s, electric load was growing rapidly throughout the country, particularly in the Southeast. Between 1965 and 1973, demand on SCE&G's system more than doubled. In 1970 alone, SCE&G's demand increased 13%.

In response to this demand growth, SCE&G like other utilities around the country embarked on large-scale construction programs. Construction of the V.C. Summer Nuclear Station, the Fairfield Pumped Storage Facility and Williams Station all began in the period 1970-72. The new investment represented by these three plants was greater than the Company's entire rate base in 1970.

To support this construction program financially, SCE&G had to have access to substantial amounts of new capital on an on-going basis. The question for lenders and investors was whether the Commission would support SCE&G's investment in these facilities and grant the Company the revenue needed to support this new infrastructure.

That question took on a new urgency when a combination of factors in the mid-1970s put the energy economy into a tailspin. The Arab Oil Embargo of 1973 touched off a period of serious financial turbulence in the United States, with double-digit inflation, high unemployment, a sustained recession, and soaring interest rates. This period of general economic uncertainty was felt nowhere more deeply than in the energy sector. In a single 12-month period in 1973, SCE&G's electric fuel costs rose 102%. Moreover, the load growth the Company counted on to support its construction program did not materialize. By the end of 1973, growth in electric demand had dropped to less than half its pre-1973 levels. Energy prices became a major political issue in the State and the Commission came under intense pressure not to allow SCE&G the revenues it needed to support its construction program.

The effects of these developments on SCE&G's financial position were immediate and devastating. The Company's stock value tumbled as doubts about its continued financial viability began to surface. At one point during 1974, the stock was trading 40% below book value. There were times when the Company's continued solvency was even in question.

Q: HOW DID THE COMMISSION RESPOND?

A. In the face of intense public scrutiny, and during difficult economic times for both the consumer and the Company, the Commission granted

SCE&G reasonable levels of rate relief. In doing so, the Commission sent a clear signal to the financial community that SCE&G would be allowed to earn a reasonable return so long as it continued to make prudent investments in assets needed to provide electric service in South Carolina. These signals bolstered the market's confidence in SCE&G's stock and allowed the Company to raise capital and complete its construction program. Summer Station, Fairfield Pumped Storage and Williams Station have now been in service for decades supporting economic development and the well being of the people of this State.

Q: CAN YOU GIVE US A MORE RECENT EXAMPLE?

A. Yes. The best recent example of the sort of balanced regulation I am discussing came in the rate proceedings related to the Company's new Cope Generating Station. The Cope Station is a 410 MW coal fired plant that went into operation in 1996. Cope Station cost approximately $423 million to construct and was the first new base load generating facility undertaken by SCE&G since Summer Station was announced in the early 1970's.

When the Cope construction was announced, the rating agencies quickly put SCE&G's single-A senior secured debt ratings on the "watch list" with negative implications. The agencies explained that this action was based on uncertainties about regulatory support for the new construction cycle the Company was entering.

At the time, the markets were concerned because there was little recent data on the Commission's willingness to support major capital investments by SCE&G. That willingness had not been confirmed since the last V.C. Summer rate proceedings in the early 1980s. In addition, the middle to late 1990s were a time when the specter of rapid retail electric deregulation hung over the industry. There was a concern that the Commission might not support substantial new investments in base-load generation while electric deregulation was on the horizon.

Q: WHAT DID THE COMPANY ASK THE COMMISSION TO DO TO ADDRESS THESE CONCERNS?

A. In the 1992 Cope Rate Case, Docket 92-619-E, SCE&G asked the Commission to send a clear signal to the markets of its continued support for SCE&G's investment in new generation infrastructure. The Company asked the Commission to show that support in several ways:

i. By including in rates 100% of the Construction Work in Progress ("CWIP") related to Cope, including not just the CWIP in place at the end of the test period (September 30, 1992) but all the CWIP on the books on the date shortly before the new rates took effect (May 31, 1993);

ii. By approving a "second phase" rate adjustment that allowed SCE&G to adjust rates on June 1, 1994 to capture the additional CWIP invested in the Cope during the intervening 12 months interval; and

In second Cope proceeding, Docket No. 95-1000-E, the Company asked for the same CWIP treatment and two-phased increase it had sought in 1992. In addition, the Company asked the Commission to allow the accelerated depreciation of a number of regulatory assets on SCE&G's books thereby improving the strength and quality of its balance sheet.

In these dockets, the Company argued that by including the additional CWIP in rate base, the Commission would reduce the ultimate cost of the Cope Station, since doing so would reduce the capitalized interest included in the cost of the plant. The Company also demonstrated that Cope was a necessary, prudent and cost effective addition to its generation portfolio. It showed that under the fixed-price, milestone-based contracts for Cope's construction, the Commission staff could easily audit all Cope related CWIP before allowing the new rates to take effect.

Q: HOW DID THE COMMISSION RESPOND?

A. The Commission granted the three requests the Company made in these two dockets. The added CWIP recognition and the accelerated recovery of the regulatory assets gave the markets strong signals that the Commission would continue to grant appropriate regulatory treatment to SCE&G as it entered its new construction phase and as the deregulatory concerns played themselves out.

The result was that the rating agencies confirmed SCE&G's single-A senior secured debt rating and the markets supported a sound valuation for SCANA's equity. SCE&G was then able to raise the capital needed to complete Cope and other projects at reasonable rates, which has saved customers and the Company millions of dollars.

In addition, the Commission's actions allowed the Company to maintain a reasonable stock price during the time that deregulatory fears were hammering the stock values of traditional, integrated utilities. At the time, a number of "experts" were saying that companies of SCE&G's size were too small to survive the industry consolidations that were taking place around it. But with the Commission's support, SCANA was able to maintain a solid stock price and its independence as a South Carolina based company when the State was losing many of its locally headquartered corporations.

Q. WHAT FINANCIAL SITUATION DOES THE COMPANY FIND ITSELF IN TODAY?

A. As the Commission is aware, SCE&G's last rate filing was Docket No. 95-1000-E, during which the final increment of the investment in the Cope facility was approved for inclusion in rate base. The test year in that case was the 12 months ending March 31, 1995.

Since that time, SCE&G has been successful in off-setting the impacts of inflation and on-going investment in system infrastructure through cost controls and productivity improvements. The Company also has been able to generate much of the capital it has needed during this period internally. In the last several years, SCE&G has been able to keep a relatively low profile in capital markets.

But the situation is now changing. The Company is again making substantial new investments in its system to meet the growing electrical needs of its customers, the air quality mandates of the Federal regulators, and the dam safety requirements of the FERC.

Three projects alone reflect approximately $1 billion in capital investment SCE&G.

Project	Gross Investment Cost (Actual and Projected)
Urquhart Repowering	$248 Million
Jasper Generation Station	$478 Million
Dam Remediation	$278 Million
Total	**$1.0 Billion**

One of these projects, the Urquhart Repowering Project, has recently been completed. But the others are in their early stages. The investment in these three projects is in addition to the $394 million that the Company has invested in smaller generation improvement projects since the last rate proceeding.

In addition, SCE&G will invest an additional $920 million in other capital projects and expenditures over the next three years. This additional $920 million represent on-going investment in system infrastructure and improvements, including service to new customers, environmental upgrades and other capital needs. The Company's witness Mr. Landreth will discuss the individual projects in greater detail in his testimony.

Q. WHAT AMOUNT OF ADDITIONAL CAPITAL WILL THE COMPANY NEED TO RAISE IN THE FINANCIAL MARKET OVER THE COMING YEARS?

A. Over the next three years, SCE&G expects to issue approximately $850 million in debt and/or preferred stock to meet the capital needs discussed above. To support the issuance of this debt on reasonable terms, SCANA will issue $150 million of new common stock equity for SCE&G. This market capital will be supplemented with other capital sources to meet the overall $ 1.5 billion capital requirement for new capital investment that the Company faces over the next three years.

Q. HOW IS THE COMPANY PRESENTLY VIEWED IN THE MARKET?

A. SCANA's stock price has held up relatively well during the recent market turmoil. We have historically been seen as a company that has taken a careful and conservative approach to regulatory change in general and to retail electric deregulation in particular. In addition, financial markets have seen SCE&G as a company that operates in a healthy regulatory climate and has a reasonable risk profile. We have not built our business around off-shore investments, extensive power or gas trading activities, or highly leveraged merchant plant development. In fact, a recent report on the company by Merrill Lynch characterized our business strategy as "plain vanilla" and went on to say that was not at all bad in this market. We believe that these comments highlight the virtue of our consistent, conservative business strategy.

Yet as the Commission is aware, the stock market, and in particular some energy stocks, have taken a beating this year. Once fast-growing energy companies like Enron and Dynegy have lost substantially all of their stock value. Shares in the Williams Companies have gone from a 52 week high of over $33.00 to trade as low as $0.78 in August of this year. On the entire list of New York Stock Exchange power companies, during the summer of 2002, only 17 registered stock prices higher than they had seen a year before. Corporate misconduct and questionable accounting practices at Enron, Dynegy, WorldCom and other companies have reduced public confidence and trust in corporate America. Given this environment, investors are skeptical towards all energy company investments.

To gain the trust of this market, even a traditional and conservative utility like SCE&G must be able to demonstrate that it has sound regulatory support for its investment needs. The markets understand that SCE&G is entering a period where capital investments in our system will be substantial. The markets are again looking to gauge the level of regulatory support we can expect for our ongoing investment in local utility infrastructure.

Ultimately, what is at issue in this proceeding is SCE&G's long-term cost structure as a utility service provider. The Company needs to access national capital markets on favorable terms as it finances the capital needs it faces. If it cannot, the new financing will embed high cost capital into SCE&G's cost structure that will be a burden on customers for decades to come.

Q. HOW DO THE DEBT RATING AGENCIES VIEW THE COMPANY?

A. The Company seeks to maintain a single-A rating for its senior debt based on its understanding that this rating creates the lowest overall capital costs for the Company and its customers. SCE&G's senior secured debt is currently rated "A-" (A minus) by Standard and Poor and "A-1" by Moodys.

These ratings, however, are routinely challenged in our meetings with the rating agencies and are coming under increasing pressure. At this time, it will be difficult or impossible for SCE&G to maintain its single-A rating without rate relief.

As an example, Standard and Poors expects "A" rated companies to maintain pre-tax interest coverage ratios within a range near 4.0 times debt service and debt to total capital ratios around 45%. SCE&G has always carefully managed its balance sheet to remain in the single-A range for debt to total capital, as the proposed equity issuance shows. However, interest coverage is a function of earnings, which are in turn a function of costs, sales and rates.

In 2000, SCE&G had a 4.1 times ratio for pre-tax interest coverage. By 2002, this ratio had fallen to near the bottom of the allowable range – to 3.4 times debt service. In 2003, without rate relief, SCE&G will fall out the very bottom of the single-A range, to 3.0 times debt coverage. Even with rate relief, SCE&G will be substantially below 4.0 times debt service, and at the low end of the acceptable range. See Exhibit No. ____(KBM-1).

Q: HOW DO PRESENT MARKET CONDITIONS AFFECT THESE RATINGS?

A. To minimize capital costs, SCE&G has historically maintained financial ratios at the low end of the acceptable range for single-A rated companies. We have relied on our strong business position, our consistent history of positive regulation, and a sustained and forthright dialogue with our rating agencies, to maintain our single-A rating. At present, however, we are moving into a period when we will need to raise substantial capital in the markets. At the same time, the rating agencies are reacting to several major business failures or near failures (Enron, Williams, and WorldCom) and the perception that the agencies did not recognize the problems in these companies soon enough. As a result, the agencies have a very short-term view of companies' financial position, and expectations are becoming more and more stringent. The agencies are much more unyielding in their applications of their financial standards. For these reasons, it will not be possible for SCE&G to retain its single-A rating without rate relief at this time.

Q. WHAT WOULD BE THE IMPACT TO CUSTOMERS IF SCE&G'S DEBT WERE TO BE DOWNGRADED?

A. In today's market, a downgrade from single-A/A1 rating to a Baa1/BBB+ rating would add approximately $1.05 in financing costs for every $10.00 in capital raised over the life of a 30-year bond. Given that the Company needs to raise approximately $850 million in new bond financings over the next three years, loss of the single-A rating would add approximately $89 million dollars to the cost of these financings.

While it is not so easy to quantify, the same result occurs if SCANA's stock price drops when it is taking new shares to market. For example, if SCANA needs to raise $150 million in new equity to improve its debt-equity ratio, it can do so by issuing 5 million shares at an assumed $30 per share, or 5.6 million shares if the assumed price drops 10% to $27 per share. In the $27 per share price example, SCANA will have to generate earnings and pay dividends on an additional 600,000 shares for as long as those shares are outstanding.

The point is that the Company, its customers and the Commission all share an interest in the financial health of SCE&G and its ability to raise capital on reasonable terms. If that ability is compromised, it becomes very difficult to maintain low-cost, efficient and reliable electric service to the people of South Carolina.

Q. FROM THE INVESTMENT COMMUNITY'S STANDPOINT, WHAT ARE THE PRINCIPAL RISK FACTORS THAT THE COMPANY FACES TODAY?

A. There are certain risks we will always face. We have nuclear risk associated with V.C. Summer Station, which is a risk that we share with all utilities that own nuclear plants. We face the risk that FERC will impose poorly conceived market structures on our region that will damage our ability to serve customers reliably and efficiently or will impair the value of our generation. We face the risk that, for whatever reason, we could lose the sound regulatory environment that has historically justified investor confidence in the Company. These are important risks to SCE&G.

But more and more, financial markets also recognize that there are substantial risks associated with SCE&G's future capital needs. The market clearly is receptive to our conservative business strategy, but it also understands that we are a relatively small company by today's investor-owned utility standards. Nevertheless, we must raise substantial amounts of new capital to meet the environmental, safety and reliability needs of our utility system.

In addition, the investments we must make are not optional for us, as they might be for unregulated companies. Meeting the demands of new load and serving existing customers reliably is mandatory for us because we have a utility service obligation. We must invest in the facilities needed to serve our customers reliably (and in compliance with current environmental regulations) even if it means financing those investments in unfavorable or turbulent markets. And we are facing just such markets today.

While we have adopted a more conservative business strategy than many of our colleagues in the energy industry, we are still part of that industry. The market is extremely skeptical of energy companies. We do all we can to distinguish ourselves from those companies that have contributed to that skepticism, but we cannot insulate ourselves from the overall perception of the industry or the disruption the industry is suffering in the financial markets.

Taken together, all this means that the markets understand that we are facing mandatory capital requirements that are quite significant given our size as a company and our balance sheet. These requirements will force us to raise capital in markets that are volatile and do not view our industry favorably. In addition, the increasingly stringent requirements of the debt rating agencies will make our ability to raise that capital, and the same time preserve favorable ratings, at more and more risk. All these factors increase the risk that we will not be able to maintain financial stability as we raise this capital. In my opinion, these are some of the major features of the risk profile of the Company today.

Q. WHAT REQUEST DO YOU HAVE OF THE COMMISSION IN THIS PROCEEDING?

A. I would respectfully ask the Commission to recognize that the rate relief SCE&G is requesting here is necessary for the Company to maintain its financial stability and its ability to gain access to national capital markets on favorable terms. I would also respectfully ask the Commission to recognize that the Company can maintain a reasonable cost structure in future years only if it in fact retains this ability to raise capital on favorable terms. The Company will need substantial external financing over the next three years to fund investment in the energy, environmental and safety needs of the State. I would respectfully ask the Commission to be mindful of the fact that capital markets will look to the decisions in this proceeding to determine the capital costs the Company must pay as it raises this capital and makes these investments.

Q. WHAT ACTION IS THE COMPANY REQUESTING WITH REFERENCE TO COMMISSION ORDER 1999-655?

A. The Company is requesting the Commission to extend until December 31, 2005 the period over which it would be able to apply the accelerated capital recovery mechanism approved by the Commission in Docket No. 1999-389-E, Order No. 1999-655. This Order allows the Company in its discretion to accelerate depreciation of its Cope Generating Station when revenue or expense levels warrant. The mechanism would expire on December 31, 2002 if not extended by the Commission.

The mechanism created by Order No. 1999-655 continues to be a useful means of responding to periods when the Company experiences unusual levels of expenses or revenues. Under the mechanism, the Commission maintains at all times the ability to initiate a rate reduction proceeding if it believes that the Company's earnings will be higher than established levels on a sustained basis. The policy reasons that justified Order 1999-665 when issued continue to be valid and justify its extension. The Company respectfully requests that the Commission extend the applicability to the mechanism until December 31, 2005.

Q. DOES THIS CONCLUDE YOUR DIRECT TESTIMONY?

A. Yes, it does.

South Carolina Electric & Gas
S&P Pretax Interest Coverage Ratio

Exhibit ___(KBM- 1)